Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

13th January 2016

Submitted via email to *rule-comments@sec.gov*

RE. Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release – File Nos. S7-16-15 or S7-08-15

Dear Mr. Fields, Secretary:

HSBC Global Asset Management ("AMG") appreciates the opportunity to comment on Securities and Exchange Commission ("SEC" or "Commission") proposed Rule 22e-4 "designed to promote effective liquidity risk management throughout the open-end fund industry…" as well as the new disclosure requirements as part of Form N-1A (i.e. "the disclosure of fund policies concerning the redemption of fund shares, and the use of swing pricing") and "amendments to proposed Form N-PORT and proposed Form N-CEN that would require disclosure of certain information regarding the liquidity of a fund's holdings and the fund's liquidity risk management practices."

There are two parts to this letter. The first provides an overview of the approach to liquidity risk management that AMG has developed based on its experience managing over $421 billion[1] in assets under management for funds and institutional clients around the globe. The second sets forth AMG's response to and observations on many of the specific questions raised in the Commission's proposal.

AMG's approach to the management of liquidity risk is founded on two important principles. Firstly, the need to meet fiduciary obligations by focusing on what has been promised in Investment Management Agreements, prospectuses and in all relevant documentation; and secondly, to ensure decisions and actions are fair to all investors. In the case of open-end funds this means ensuring that the interests of those investors seeking to redeem does not negatively impact those investors who intend to remain invested.

The following forms the basis of AMG's approach to achieving these objectives:

- Clear and transparent fund literature;
- The thoughtful management of capacity at both the strategy and fund level so funds are "soft closed" proactively;
- The use where possible of partial swing pricing or similar anti-dilution mechanisms to ensure that remaining investors do not subsidize investors redeeming from funds. For example, AMG's fund range domiciled in Luxembourg, HSBC Global Investment Funds, employs partial swing pricing methodologies;
- The ability to where possible defer redemptions on any one day if a judgment is made that there is insufficient liquidity in the underlying investment market. While this process is not

1. As at September 2016

always popular with investors, AMG recognizes that doing so is in an investor's general interest; and

- In exceptional cases, where possible AMG may choose to suspend funds.

Although swing pricing (or other forms of dilution levy) is not permissible in all jurisdictions, the legal documentation governing the funds has sufficient provisions to meet benchmark liquidity management requirements.

When using swing pricing, deferring redemptions and, on rare occasions, deciding to suspend funds, AMG is acutely aware of the potential impact on the shape, characteristics and liquidity of the portfolio which might remain if the most liquid assets have been sold to meet redemptions.

AMG places significant emphasis on the use and application of practical mechanisms to manage systemic market liquidity events which can neither be predicted nor influenced by individual market participants. Provided that these mechanisms are permitted by the laws applicable to the fund, do not compromise the fair treatment of all investors, and funds are not managed in such a way that the investment strategy places heavy reliance on the availability of these measures, such mechanisms help to provide a strong practical foundation for robust liquidity management.

The key foundations that underlie AMG's approach and responses are as follows:

- Mutual funds enable investors to receive, net of costs, the returns from the funds' underlying investments.
- Mutual funds do not provide liquidity, credit or other transformations.
- The liquidity of a fund is a function solely of the market liquidity of the fund's underlying assets.
- Investors should be made aware of and accept all risks associated with investing, including liquidity risk.
- It is not possible to be completely certain of both market liquidity and investor behavior.
- Remaining investors in a fund must not be adversely impacted by investors who choose to redeem holdings.
- Funds should be permitted to use as many tools as possible to help ensure fairness to all investors (e.g., semi-swinging prices, deferred redemptions and, in extreme situations, suspension of subscription and redemptions).

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FUNDS DO NOT DELIVER MATURITY (LIQUIDITY) OR CREDIT TRANSFORMATION

Open-end funds offer an attractive investment option for many different types of investors as they can deliver economies of scale, diversification, professional management and enable investors to experience returns from assets in which the fund is invested in line with the fund's investment objectives. The pooling of monies can also provide retail investors with access to certain investment strategies or markets that might otherwise be difficult (perhaps impossible) or time consuming for investors to replicate themselves.

Although open-end funds should be able to convert some portion of their portfolio holdings into cash on a frequent basis because they issue redeemable securities, expectations that funds will always offer daily pricing and investment "redeemability" are unrealistic. Funds' ability to raise liquidity depends on their capacity to divest the underlying investments within a given timeframe and with acceptable market impact. The changing and often binary nature of market liquidity complicates this process. Investors' perception that funds can deliver the benefits of returns while also providing the same or similar liquidity of a call deposit is profoundly misaligned to the risks associated with investing. **Open-end funds are not banks and nor can they promise to deliver maturity (liquidity) or credit transformation**.

THE RISKS ASSOCIATED WITH INDIVIDUAL SECURITIES ARE NOT TRANSFORMED BY WRAPPING THOSE UNDERLYING SECURITIES UP WITHIN A FUND

The risks derived from directly investing in securities or investing in funds which hold securities are similar. The principal benefits from investing in funds arise from pooling (e.g., diversification, lower costs, and access to investment opportunities) that may otherwise not be available or easily available to individual investors. **Investors must recognize that investing in securities through a fund does not remove the risk that would normally come from directly holding those securities (e.g. investment, credit or liquidity risks).** Also, versus the underlying securities, funds can potentially introduce other types of risks depending on the type and complexity of trading strategies employed, the nature of underlying investments, use of leverage, etc.

Valuation and liquidity may not be well understood by investors. In a strict sense, given transaction costs etc., the net asset value that is quoted at which transactions take place does not represent the value that would be received if the entire fund were to be liquidated immediately. Nevertheless, the net asset value is a fair basis for marginal transactions. Liquidity is similar in that while in normal circumstances it is reasonable for the investor to expect Asset Managers to manage the funds so that redemptions can be met, **it is unreasonable for investors to expect that all investors can redeem at the same time in the same way**.

THE IMPORTANCE OF DISLOSURE AND RISK ACCEPTANCE

Asset Managers are obliged (and required) to go to great lengths to ensure investors understand that **investing in funds is not without risk**; and yet **expectations of how Asset Managers must manage liquidity risk appear inconsistent with the pass-through nature of a fiduciary agency.** Just as Asset Managers cannot immunize investors from all other risk factors (market risk, regulatory risk etc.), it would not be appropriate to create an expectation that they can deliver a different outcome with liquidity risk without inadvertently creating other adverse consequences (e.g., leverage, inappropriate risk transfer). **AMG does not believe liquidity risk is or should be treated differently to other risks**.

Rather than attempt to control liquidity risk and in doing so, create potentially unintended risks not fully understood or managed, a more practical approach to managing liquidity risk would be to ensure that all risks, including liquidity risk, are adequately described within fund documentation so investors better understand the risks they are taking in pursuit of returns and they are able to make an informed decision as to whether these risks are aligned to their own risk appetite. Failure to achieve this through adequate disclosures or disguising inherent risks (such as liquidity risk) within funds can result in moral hazard.

INVESTOR PREFERENCE FOR LIQUIDITY IS NOT ALWAYS ALIGNED

Even within the same fund, it is important to recognize that investor preference for liquidity ahead of other drivers such as return, capital preservation etc. is not the same. Investors that wish to match longer term liabilities are likely to have more stable redemption/subscription behavior and be less concerned about short term volatility and falls in asset prices.

Liquidity demands on a fund of relatively illiquid assets (e.g., bank loans, private equity or real estate) held by long-term investors who understand and seek the risk premium illiquidity brings could be lower versus another fund of assets deemed to have some level of liquidity by asset-analysis, but which is subject to significant levels of short-term investor trading.

MATCHING A FUND'S LIQUIDITY WITH THAT OF ITS UNDERLYING INVESTMENTS

Investor expectations that funds can and should always offer daily pricing and investment "redeemability" are unreliable assumptions that can be misaligned to the true reality of market liquidity. In "normal" market conditions the pattern of subscriptions and redemptions and the ease of trading in the marketplace means investors often receive an enhanced liquidity experience through the fund than if they were investing themselves directly in the underlying assets, but in stressed market conditions, when net redemptions might increase at the same time as it becomes more costly or impossible to liquidate securities in the market, an investor's ability to redeem their investments may be negatively impacted by the prevailing market liquidity of the underlying assets. **Investors must understand that the liquidity of their investment in a fund ultimately depends on the liquidity of the underlying investments in that fund**.

To help to focus investor expectations of how quickly they can liquidate their investments as part of the selection and purchase decision making rather than offering a false promise that liquidity will always be fully within the control of their Asset Manager, AMG strongly believes that Asset Managers should align a fund's redemption policies more closely to the liquidity of the underlying assets within those funds.

ASSET MANAGERS SHOULD NOT BORROW TO MEET REDEMPTIONS

AMG firmly believes that Asset Managers should not meet redemptions through borrowing facilities for the funds other than to meet short term settlement mismatches. Such actions are inappropriate as it gears the funds to the potential disadvantage of those investors who are not redeeming and **misleads investors into thinking that liquidity ought to always be available to them**. **AMG would like to reiterate that investors must understand that investing in the financial markets**

involves risk and the market liquidity associated with investing in a fund is both practically and legally different to the liquidity obligations bestowed upon a bank depository.

CHALLENGES ASSOCIATED WITH PREDICTING INVESTOR BEHAVIOR

Attempts to predict the behavior of the investors in a fund is at least as difficult, if not more difficult, than trying to measure and predict market liquidity, as:

- The Asset Manager does not have perfect look through into the end clients circumstances;
- Even where investors are on the register directly, the Asset Manager does not always have a direct relationship with investors as the fund may be sold through distributors, hence the Asset Manager will lack the requisite knowledge of their habits and behaviors;
- Any attempt to look at investor behavior using historical inflows and outflows is complicated by the fact that the Asset Manager is only able to review them in aggregate and there are intrinsic limitations to any model which seeks to predict the behavior of the current investors in the fund; and
- AMG has seen that investor redemption behavior changes dramatically as markets change so even if an Asset Manager has the history of the investors in the fund, it would not necessarily help them to build a perfect picture in stressed conditions.

CHALLENGES ASSOCIATED WITH MEASURING MARKET LIQUIDITY

The process for measuring liquidity is highly subjective and requires judgments as to the practical ability of a fund to sell a security, assumptions and/or the use of proxies where data availability is limited or thought to be unreliable. Market liquidity can be difficult to measure, partly because the liquidity observed in an unstressed market cannot always be relied upon to accurately estimate risk during periods of market stress. There are considerable challenges with information gaps, the general unpredictability of markets, and investor behavior.

AMG recognizes and employs stress testing as a useful way of highlighting potential problems, identifying opportunities for risk reduction, and assisting in the creation of contingency plans, **but the binary nature of liquidity means that in extreme market events, liquidity shocks usually occur quickly and cannot easily be predicted by any model**.

AMG'S VIEW ON THE USE OF A LIQUIDITY MANAGEMENT FRAMEWORK

AMG endorses the SEC's proposal to require each fund to adopt a formal, written liquidity risk management program reasonably designed to assess and manage a fund's liquidity risk. However, **given the challenges associated with measuring market liquidity, forecasting liquidity crises (both in emerging and developed markets), as well as accurately predicting liquidity demands of investors, AMG does not believe the imposition and maintenance of minimum required liquidity buffers will help funds meet redemption requests at all times, particularly during periods of market stress, which are often when liquidity is most in demand**. Most jurisdictional liquidity requirements implicitly prohibit Asset Managers from "cherry picking" the most liquid of a fund's assets to divest (in stressed conditions) on the basis that this negatively impacts the remaining investors in the fund. **However, it could also be argued that requiring a fund to retain more of its net assets as a liquidity buffer to meet potential future redemption requests negatively impacts**

HSBC Global Asset Management

a number of investors in that fund, particularly those investors whose preference for liquidity is not the greatest driver for investing.

AMG is also less supportive of publicly disclosing liquidity metrics as investors are likely to lack the requisite knowledge of how these metrics have been calculated, which methodologies the underlying liquidity models employ and any limitations associated with how the metrics have been derived. Indeed, AMG believes these disclosures would likely provide a misleading view of comparability among funds.

Notwithstanding this, as outlined in this response letter, there are several ways to manage liquidity and there are a number of approaches that AMG believes should be taken to help ensure Asset Managers manage fairly the conflicts between investor interests, in particular the potential conflicts between redeeming/subscribing investors and those that remain in the fund.

AMG appreciates the opportunity to provide comments to the Commission regarding the proposals.

Yours sincerely,

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Should the Commission have any questions regarding these comments, or if we can provide further information, please do not hesitate to contact:

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<u>Responses to the questions raised by the Commission</u>

QUESTION 1

Do commenters believe that the general elements of the program would enhance a fund's ability to assess and manage its liquidity risk?

AMG believes the proposed liquidity risk program might be of some benefit to those Asset Managers who do not currently have a dedicated liquidity risk framework or to those managers, who the SEC has identified as managing funds that employ liquidity management practices "*that are substantially less rigorous*". The program would particularly benefit investors whose Asset Managers do not currently take "*different market conditions into account when evaluating portfolio asset liquidity, do not conduct any ongoing liquidity monitoring*" or incorporate any "*independent oversight of fund liquidity risk management outside of the portfolio management process*."

The program offers a useful framework for how the industry might look to manage liquidity risk, but like other programs such as those intended for UCITs or AIFs, the framework does not provide guidance on what approaches or specific methodologies Asset Managers should adopt to calculate/measure liquidity. Although some third parties offer liquidity measurement/monitoring solutions, no industry standard has yet to be developed. As a result it is likely that Asset Managers will adopt their own models resulting in variation across the industry reducing the comparability of disclosures. **<u>AMG does not believe detailed guidance can be provided that would be suitable for all funds in all conditions. The Asset Manager must retain the flexibility to exercise professional judgment in the best interests of investors within broad guidance.</u>**

QUESTION 2

Are there any elements that should be excluded from the program requirement, or are there any additional elements that should be included in the program requirement?

<u>AMG is supportive of the general elements of the program, but strongly opposes the use of hard liquidity guidelines.</u> AMG accepts the rationale for imposing a *"…minimum portion of net assets in assets that the fund believes are convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale*" as a possible method of protecting investors, but believes it is highly unlikely that the imposition of hard guidelines, requiring a fund to hold more liquid assets, will enable the fund to meet redemption requests in anything other than normal conditions (i.e., both normal market liquidity conditions and typical redemption requests).

Industry practitioners recommend considering a number of factors when assessing the potential liabilities of a fund including, but not limited to, the number of investors, the size/concentration of their holdings, their type (e.g., long term investor), investor behavior and historical redemptions. However, this analysis is often limited due to challenges with data availability (e.g., hidden under nominee structures) or data limitations (e.g., over-reliance on historical redemptions as a way of predicting future redemption activity). The lack of efficient data management technologies also prohibits firms from accurately projecting investors' inflows and outflows.

AMG has experience in trying to measure market liquidity as well as projecting the liquidity demands of investors. On the basis that both are impossible to do with a high degree of accuracy, AMG believes there is limited value in demanding funds to allocate more net assets into relatively more liquid holdings. In doing so, investor returns are likely to be impacted by holding proportionately more liquid assets and funds that are managed relative to a benchmark are likely to experience a higher tracking error.

There are considerable challenges with information gaps, the general unpredictability of markets, and investor behavior. Furthermore, the process for measuring liquidity is highly subjective and requires judgments as to the practical ability of a fund to sell a security, assumptions and/or the use of proxies where data availability is limited or thought to be unreliable.

Liquidity risk can be difficult to measure, partly because the liquidity observed in an unstressed market cannot always be relied upon to accurately estimate risk during periods of market stress.

For fixed income securities, the commonly adopted measure of liquidity (the bid-ask spread) can be flawed in two respects. Firstly, the spread is not always available (or is stale), and secondly, the spread does not take into account the volume/scale of a Portfolio Manager's intended buy and sell transactions. This challenge often exists for illiquid securities, where the analysis of liquidity matters the most.

AMG recognizes stress testing as a useful way of highlighting potential problems, identifying opportunities for risk reduction, and assisting in the creation of contingency plans, but the binary nature of liquidity means that in extreme market events, liquidity shocks usually occur quickly and cannot easily be predicted by any model.

In order to determine whether a price move does not *"materially affect the value of that asset immediately prior to sale"* Asset Managers must perform an assessment of *market impact*. This requires a suitable market impact model to predict future prices taking into account the impact of liquidity on future prices. Although a number of approaches are employed in the industry (e.g. Liquidity VaR), Asset Managers face difficulties when attempting to calculate market impact with a degree of certainty.

AMG believes further guidance from the SEC would be helpful to, for example, assist Asset Managers understand what might constitute an acceptable price impact for particular types of securities. Without this guidance, Asset Managers will employ their own definitions of materiality, resulting in inconsistent metrics across the industry, leading to difficulties for investors to make sense of the calculated metrics and form a useful basis of comparison.

AMG is supportive of measuring liquidity and calculating suitable metrics such as the three day liquid assets bucketing methodology. This is not unlike the approach currently taken by AMG to classify the holdings of a fund into three buckets, depending on the perceived liquidity of the assets (i.e. *high*, *moderate* or *low* liquidity). However, AMG believes using this information to infer a set of meaningful and accurate metrics which must be used for fund construction is imprudent, is not in the best interests of investors, and prevents Asset Managers from fulfilling their fiduciary obligations.

AMG currently uses internal risk guidelines alongside a number of other metrics, all of which are designed to help inform Portfolio Managers of the various risks to which a fund is exposed. **AMG firmly supports the use of internal risk guidelines as a mechanism for providing an indicative view of a fund's potential liquidity requirements, a way of monitoring a fund's appetite to liquidity risk, and to provide a trigger for the Risk function (or other control function) to discuss potential concerns with the Portfolio Manager and to consider appropriate follow up actions.**

QUESTION 3

Do commenters believe that the program would enhance funds' management of liquidity risk better than they already do in practice? Do commenters believe that the program would materially strengthen a fund's ability to meet its redemption obligations and would materially reduce potential dilution? Should the rule focus not just on the liquidity of the fund's assets but also more specifically and prominently on its liabilities, such as derivatives obligations, that may affect the liquidity of the fund?

While investors in actively managed funds may reasonably expect to incur costs caused by the Asset Manager's trading activities in pursuit of the investment objectives outlined in the fund prospectus, they would not reasonably expect to suffer a reduction in shareholder value influenced by other shareholders trading into or out of the fund. **AMG strongly supports the proposal for Asset Managers to use partial swing pricing, where deemed appropriate, to allow the cost of material investor purchase or redemption activity to be passed on to those groups of investors and protect the interest of the remaining investors within the fund.**

However, as stated previously the estimation of market liquidity and investors' liquidity demands both require the use of imperfect data, models, assumptions and approximations. On this basis, **AMG does not believe the program would materially strengthen a fund's ability to meet its redemption obligations, particularly under stressed market conditions, which are impossible to foresee and pre-emptively position a fund in such a way that the fund will have sufficient liquidity to meet redemption obligations at all times.**

AMG acknowledges there are challenges with building a complete and accurate picture of liquidity. However, to the extent that this is possible, Asset Managers should attempt to take all liabilities into account when trying to calculate liquidity for a given fund. This includes any obligation or potential obligation derived from derivatives contracts, both exchange traded and over-the-counter ("OTC").

The degree to which a fund employs leverage can have a material impact on its liquidity demands, particularly during periods of market stress. As such, attempts to model liquidity risk should incorporate an assessment of leverage and the extent to which this might intensify liquidity demands for a given fund during different scenarios compared to unleveraged funds. Collateral and/or margin commitments relating to exchange traded and OTC derivatives, the variability of these payments, and an estimation of potential obligations in a stressed market scenario could also be captured.

For OTC securities, a number of additional checks could be considered, such as whether there are any legal or practical (including contractual) limitations on terminations, transferability, or sale as well as the number of counterparties who have executed agreements (e.g., ISDA) to transact with the fund in question and/or are willing to assign contracts.

Although Asset Managers are well placed to identify the drivers of market liquidity as well as the factors that impact a fund's liquidity obligations, the challenge the Asset Manager has is to successfully incorporate these relevant factors into a series of predictive models that react on an intraday basis to identify material changes in market liquidity.

AMG believes it is important that investors understand that all funds investing in the financial markets are exposed to market liquidity and hence liquidity risk. This is true regardless of fund structure, type, domicile etc. The extent to which asset liquidity varies between funds depends on a variety of factors including, but not limited to, investment strategy, investment composition, levels of leverage etc., however, the extent to which illiquidity could be problematic for investors depends on their individual liquidity demands.

It is also important to understand the type of investors in the fund, where the underlying investors are known, their liquidity demands and their preference for liquidity ahead of other drivers such as alpha generation, capital preservation etc. Some investors (e.g. Insurance firms who, for example, match longer term liabilities) are likely to have more stable redemption/subscription behavior and be less concerned about short term volatility and falls in asset prices.

Even a highly leveraged fund holding less liquid securities is prone to a market liquidity shock, but if investor liquidity demands are more stable, even during periods of market stress, liquidity risk poses less of a problem to that fund.

AMG believes it is more important that investors who have chosen to invest in a given fund understand the risks (including liquidity risk) the fund is exposed to and have chosen to accept these risks in pursuit of the returns they are seeking to generate. A fund of relatively illiquid assets (e.g., bank loans, private equity or real estate) held by long-term investors who understand and seek the risk premium illiquidity brings, is likely to have lower liquidity demands from investors than a fund of assets deemed to have some level of liquidity by asset-analysis but which is prone to liquidity shocks.

QUESTION 4

To what extent do funds currently have policies and procedures resembling the proposed program requirements? Have funds' current policies and procedures proven effective at managing liquidity risk, and how have they evolved in recent years? Are these policies and procedures primarily overseen by a fund's chief compliance officer, chief risk officer (if any), or someone else?

AMG has experience in managing a variety of different fund structures in accordance with a range of multi-jurisdictional liquidity risk requirements. AMG's liquidity risk program is supported by a firm-wide liquidity risk policy which requires an assessment of liquidity risk on a fund-by-fund basis and to ensure "*sufficient controls are in place to manage and mitigate Liquidity Risk*" and to "*establish an effective Liquidity Risk Management Process which is compliant with local jurisdictional liquidity requirements and effective in varied market conditions*."

AMG's policy provides guidance and sets minimum standards on liquidity management tools, disclosures, governance processes, asset liquidity, fund liabilities and internal limits, the role of the Portfolio Management and/or Trading function, and stress testing. These aspects are also carefully considered at the design stage for each fund.

AMG considers both quantitative and qualitative factors to help ensure that in all but exceptional circumstances each fund can meet its liabilities as they fall due. In doing so, AMG businesses are required to assess/conduct:

i. **Asset liquidity –** regularly measure and monitor asset liquidity, where possible incorporating relevant data and factors, in order to create a robust and holistic view of the possible risks.
ii. **Liability assessment –** understand or estimate to the extent possible given the use of nominee accounts or distributor's aggregate accounts the liability profile of each fund, with a

strong understanding of any collateral or margin obligations and the investor base including (i) the number of investors in each fund, (ii) the shareholding of each underlying investor, and (iii) redemptions under normal and stressed market conditions.

iii. **Liquidity Risk Limits –** establish and maintain suitable internal guidelines which are proportionate to the redemption obligations and liabilities of the fund. These must be fund-specific and determined through an assessment process that takes into account the liquidity that the fund requires in order to meet its liabilities over different timeframes.

iv. **Stress testing –** conduct regular assessments of liquidity in different scenarios, including stressed situations (e.g. atypical redemption requests or periods of market disruption). In doing so, AMG analyses the number of days that it would take to sell assets and meet liabilities in the simulated scenarios, taking into account the following:
   - The expected behavior of other market participants in the same conditions and the impact on the assets held;
   - The impact that the stress event and other inter-related events will have on trading volumes, market depth, spreads etc.;
   - The expected behavior of the investors in the fund and the impact on the redemption profile of the fund;
   - Any actions that the AMG business may take.

AMG's Risk Management Committees discuss liquidity risk, review exceptions within individual funds together with the appropriateness of any action taken. In extremis AMG's Crisis Committee, chaired by the Global Chief Executive Officer, meets as required to advise on significant market and/or economic/political events that impact market liquidity.

The current policies and procedures used by AMG have been effective in managing liquidity risk. In recent years AMG has focused on the implementation of a new firm-wide liquidity risk management framework, aligned with the IOSCO guidelines on Principles of Liquidity Risk Management[2] which includes enhancing risk disclosures within investor documentation, tools and mechanisms across fund ranges, and providing more clarity on the factors that should be considered when assessing market liquidity and liquidity demands. AMG has established a working group that is assessing what improvements can be made to the AMG liquidity risk measurement systems and tools.

The AMG policies and procedures are the responsibility of the Risk Management function and fall under the oversight of the AMG Global Chief Risk Officer, but also involve other functions such as Product who are responsible for the development and oversight of funds.

2. BOARD OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO) (March 2012). Principles of Liquidity Risk Management for Collective Investment Schemes. Retrieved from https://www.iosco.org/library/pubdocs/pdf/IOSCOPD405.pdf

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QUESTION 5

Do commenters agree that closed-end funds, including closed-end interval funds, should not be included within the scope of the proposed rule? Should we make any changes to the liquidity requirements for closed-end interval funds?

AMG supports the Commission's proposal to exclude these funds from the scope of the rule, because closed-end funds do not issue redeemable securities and their liquidity demands differ to open-end funds. AMG does however recommend that Asset Managers ensure that closed-end funds with a fixed life or a fixed maturity carefully align the liabilities of these funds with suitable investments that have a similar maturity profile.

QUESTION 6

Do commenters agree that we should specifically exclude money market funds from the scope of proposed rule 22e-4?

AMG agrees that money market funds should be excluded from the scope of proposed rule 22e-4. AMG has analyzed the inherently liquid nature of money market funds and their inherent bias towards capital preservation, compared to more traditional multi asset funds, and feels there would be minimal value realized by investors' by including such funds within the scope of the proposal. **AMG also believes that the SEC has already taken valuable steps to address liquidity risk in money market funds in its 2a-7 reforms**, due to come into force in April and October this year.

QUESTION 7

What procedures or practices do funds currently use to assess and classify the liquidity of portfolio assets?

When calculating asset liquidity, AMG's policy requires AMG to ensure each asset held within each fund is categorized into one of three groups according to the following broad definitions:

i. **Highly liquid** – assets AMG would expect to be able to sell into deep and liquid markets at or close to the valuation in all but the most extreme circumstances.
ii. **Moderately liquid** – assets AMG would expect to be able to sell at or close to valuation over a short period in all but the most extreme circumstances as the market is less deep and/or the size of the holding larger than normal (daily) market volumes.
iii. **Less liquid** – assets AMG would expect to be able to sell over a period of several days or via a block trade in all but the most extreme circumstances as the market is not considered sufficiently deep.

AMG has detailed liquidity management procedures setting out how these calculations should be performed for individual security types.

For example, for equity securities where there is good market trading data, an empirical approach is taken. The daily permissible threshold at which a security could be executed without there being a material impact on price is currently defined as 20% of the average daily volume of the security over the last 30 trading days. The holding in a security is then divided by this number to give the estimated number of trading days needed to exit the position. If the number calculated is less than 1 then the security is defined as highly liquid, between 1 and 5 moderately liquid, and everything else less liquid. AMG Risk Management Committees have the discretion to choose a different definition (e.g., averaging over a longer period) as long as approval has been obtained from the Global Chief Risk Officer.

Furthermore, **AMG has defined methodologies to determine the possible redemption levels for a given fund under both normal and stressed market conditions that incorporates factors such as the number and size of the investors within the fund, where this information is available.**

QUESTION 8

Have these procedures proven effective in the past? If not, under what circumstances were they ineffective, and why?

AMG is of the opinion that this approach and the associated reporting has proven broadly effective during periods of normal market conditions as a method of complementing the active liquidity risk management undertaken by the Portfolio Manager, however, AMG acknowledges the limitations related to monitoring market liquidity as a way of attempting to predict rapid and material declines in liquidity.

The recent market volatility in the China equity and fixed income markets[3] supports the idea that liquidity cannot always be measured nor can illiquidity be predicted. The situation culminated when more than 50% of the stocks traded on China exchanges were suspended. As a result, the AMG Crisis Committee convened to agree the best approach for AMG to manage funds investing in these securities, to consider fair value pricing methodologies, and determine how the funds should best handle redemptions and suspensions for funds where a significant proportion of the holdings were suspended; in doing, the AMG Crisis Committee sought to ensure decisions and actions taken were done so in the best interests of all investors. Other recent examples include the China Securities Regulatory Commission's decision to intervene in automated stock-trading in Chinese securities via the introduction (and subsequent withdrawal) of a "circuit breaker" and the troubles experienced by Third Avenue Management LLC's Focused Credit Fund.

Notwithstanding the argument that the estimation of market liquidity and the "bucketing" of position holdings according to their relative "spectrum" of liquidity helps to paint a pixelated picture of market liquidity, **AMG does not believe it possible to predict the occurrence of material systemic failures of liquidity**. History has shown that market liquidity can change rapidly. In the context of the SEC's three-day-liquid-assets calculation, assets which today are perceived to be liquid in three days may not necessarily be easy to liquidate in three days tomorrow, or even this afternoon. By way of example, term securitization was one of the most "liquid" markets, as defined by *relatively tight* bid/offer spreads, pre-2008 crisis but liquidity evaporated rapidly during the crisis quickly making it one of the most illiquid markets.

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3. On 11 August AUG China devalued the Yuan by 2% against the US Dollar. Over the period June through September 2015 there was significant market volatility in the China equity and fixed income markets. The situation culminated when more than 50% of the stocks traded on China exchanges were suspended.

QUESTION 9

Have funds modified their procedures for assessing and classifying liquidity in recent years to account for changes in market structure and the advent of new types of market participants?

AMG is constantly reviewing the methodology used to measure liquidity. Over the years new factors have been included and the weightings, which represent the importance of those factors in terms of their contribution to liquidity risk for a specific security, are updated to reflect general and structural changes in market liquidity.

QUESTION 10

Who at the fund and/or the adviser is tasked with assessing the liquidity of the funds' portfolio assets?

Although the Fund Board is ultimately responsible for overseeing the management of all risks, within AMG a variety of different functions, representing the business and control functions, are responsible for the maintenance of controls relating to the management and mitigation of liquidity risk.

i. **The Portfolio Manager** is responsible for managing liquidity within the fund to meet redemption requirements as well as determining whether exceptions generated from the risk reporting require action.
ii. **The Product function** is responsible for verifying funds are assigned suitable tools and exceptional measures will be used to manage liquidity risk at the new product approval stage, as well as verifying suitable disclosures have been written into fund documentation.
iii. **The Risk Management function** is responsible for establishing and maintaining the liquidity calculation models, assigning internal guidelines, monitoring and reporting key findings to the Portfolio Manager and the AMG Risk Management Committees. The Risk Management function is also responsible for performing stress testing together with any guidance on model calibration and the maintenance of the overall policy framework relating to liquidity risk.
iv. **The Compliance function** is responsible for advising on regulations relating to liquidity risk.

QUESTION 11

Are any third-party service providers used in assessing portfolio assets' liquidity, and if so, how are such service providers used and what are the costs associated with their services? Would the proposed requirements require funds to make systems modifications and what costs would be associated with any potential system modifications? What would the associated costs and other burdens be for funds to assess and classify the liquidity of portfolio assets?

AMG does not currently utilize a third-party vendor solution but this is an area AMG has been exploring. A series of discussions have taken place between AMG and third party vendors such as Markit and Bloomberg L.P., to understand their service offerings, primarily as a way of validating whether AMG's current modelling approaches remain up to date and fit for purpose.

No concrete discussions have taken place on costs at this stage, but AMG anticipates the costs associated with such a service are likely to be significant. As such, it is difficult to ascertain what the cost per fund might be as preliminary discussions indicate that vendors are charging on a per security basis (with additional cost factors) rather than on a per fund basis.

QUESTION 12

Do commenters agree that it would be useful for a fund to consider portfolio positions' liquidity in terms of a spectrum instead of a binary determination that an asset is liquid or illiquid, and do funds currently consider the relative liquidity of portfolio assets by classifying assets (either explicitly or informally) into multiple liquidity categories?

AMG is not supportive of a binary approach to liquidity although it is worth noting that in extreme tail events market liquidity does exhibit binary characteristics. A more practical approach to "estimating" liquidity for fund holdings is to use a scaled methodology to assess market liquidity for individual assets and, as the SEC has recommended, portions of individual assets.

QUESTION 13

Do funds currently consider the period in which a fund's position in an asset can be converted into cash (that is, sold, with the sale settled) in assessing and classifying the liquidity of portfolio assets?

AMG's current approach does consider time to liquidate.

QUESTION 14

Do commenters agree that it would be useful for a fund to assess the liquidity of its entire position in a portfolio asset, or portions of a position in a particular asset, as opposed to the liquidity of a single trading lot of a portfolio asset held by the fund?

AMG supports the SEC's method of assessing how much of a fund's position in a given investment can be sold during a given timeframe as opposed to a single trading lot basis, this is more reflective of how securities are bought and sold. AMG would like to reiterate that it is not possible for Asset Managers (or anyone else) to predict this with complete accuracy. If the Asset Manager does not possess perfect information on the behavior or activities of all market participants concerning bids and offers, the Asset Manager is unable to know precisely how much of a given position they will be able to transact (dispose of) whilst minimizing market impact.

QUESTION 15

Do funds currently consider the ability to sell varying portions of a fund's position in a portfolio asset (fractions of the position, as well as the entire position) in assessing that asset's liquidity?

AMG currently considers the ability to sell portions of a fund's position in a given asset when assessing liquidity, however, discretion and conservatism are employed in this pursuit. The accuracy of incremental liquidity estimates and degrees of confidence assigned to them vary significantly across asset types and markets. For example, highly active exchange-traded equities provide greater price/volume data transparency as well as market activity stability necessary to make reasonable attempts at estimating incremental liquidations as compared to thinly-traded OTC fixed income securities or more esoteric instruments. The likelihood of executing block and odd-lot fixed income trades will depend on not only historical trading volumes, but also the average trade sizes and distribution of those trade sizes. Where there is not sufficient transaction data to make a reasonable estimate of incremental liquidity, the entire position is likely to be modelled versus a portion of the assets.

QUESTION 16

What assumptions, estimations, and judgments would funds need to make in order to determine liquidity classifications, and how would these assumptions, estimations, and judgments affect the comparability of reporting across funds? Are there concerns, such as proprietary or liability concerns, associated with reporting liquidity classifications based on such assumptions, estimations, and judgments?

AMG has a number of different approaches to measuring liquidity that are tailored to different markets and security types. The primary tool to estimate market liquidity is the internally developed Liquidity Risk Model. This model uses a factor-based approach to assess and estimate the liquidity of an asset based on the culmination of numerous market, security, and position characteristics that are widely considered and/or have been demonstrated empirically to explain various measures of asset liquidity.

The model relies heavily on the quality and availability of data including security terms and conditions, prices, spreads, traded volumes, and market structure. Both expert judgment and statistical methods are then used to identify relationships between these characteristics and various proxies for asset liquidity, such as bid-ask spreads and observed traded volumes. Often these proxies only address one element of liquidity, cost to transact versus speed to transact, and are ultimately imperfect measures. In addition the degree to which factors, individually and in aggregate, explain a given asset's liquidity over time and under different market environments are unstable by nature.

Thus direct comparability across funds may be difficult as the published metrics will reflect the professional judgment of those involved. Full disclosure of the methodology would improve comparability, although whether retail investors would fully understand the differences may be debatable.

AMG recognizes that the risk to the Asset Manager may be increased as investors may not read or understand all the caveats or health warnings about liquidity disclosures. Thus if as a result of an extreme event (e.g. a market closure as took place after the events of 9.11) daily liquidity was not available, investors may seek recourse against the Asset Manager. This is a concern AMG would mitigate by full disclosure and appropriate warnings. Investors must understand that the risk/reward trade off they are making when they choose to invest in a mutual fund includes the risk that daily liquidity may not be always available.

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QUESTION 17

The proposed rule would require a fund to determine, using information obtained after reasonable inquiry, the number of days within which a fund's position in a portfolio asset (or portion of a position in a particular asset) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale. Do commenters believe that the terms "information obtained using reasonably inquiry," "at a price that does not materially affect the value of that asset," and "immediately prior to sale" are sufficiently clear? If not, how could they be made clearer?

AMG requests clarification on the expectation of an Asset Manager *"using information obtained after reasonable inquiry"* and what level of inquiry the SEC expects an Asset Manager to make for very illiquid securities or securities that trade on an infrequent basis – it is likely to be impractical if the SEC requires the Asset Manager to ask Traders for bid/ask quotes.

QUESTION 18

Do the proposed liquidity categories reflect the manner in which funds currently assess and categorize the liquidity of their portfolio holdings as part of their portfolio and risk management? Should we increase or decrease the number of liquidity categories to which a fund might assign a portfolio position? For example, should we combine the last three liquidity categories (convertible to cash within 8-15, 16-30, or in more than 30 calendar days) into one liquidity classification category (e.g., "convertible to cash in more than 7 calendar days")? Why or why not? Should we add one or more liquidity categories outside of the more than 30 calendar day time period (e.g., "convertible to cash in more than 90 calendar days")? Why or why not? Should we revise the time periods associated with any of the proposed liquidity categories? Alternatively, should we permit a fund to classify the liquidity of its portfolio securities based not on conversion-to-cash time periods specified by the Commission, but instead based on conversion-to-cash time periods that the fund determines to be appropriate (taking into account the fund's redemption obligations)? Would such an approach diminish comparability in funds' reporting of their liquidity assessment on proposed Form N-PORT, discussed below?

The notion that every security can be easily categorized into six different buckets, some based on business days, some based on calendar days, is a hugely difficult undertaking due to the data and modelling limitations. Ironically, those securities that are perhaps least liquid often have the least amount of data available. Conversely, certain securities with limited data (i.e. if the security doesn't trade frequently) may be highly liquid but, the challenge is finding the data points to verify and prove. The greater the number of categories the less likely it is that comparability across funds will be easy. AMG's core position is that it is not possible to precisely define liquidity.

The SEC Proposal acknowledges the probability of different funds classifying the liquidity of identical positions differently and affirms that the proposed rule does not assign certain asset classes to particular liquidity categories; nonetheless, because of the subjective nature of liquidity modelling, challenges with data accuracy and completeness and the necessary use of assumptions and/or approximations to overcome these challenges, AMG believes it is likely that investors may draw the wrong conclusions from the differing disclosures for different funds.

AMG is requesting further clarity from the SEC on whether Asset Managers are required to calculate market liquidity based on an assessment of normal market conditions or stressed market conditions; the number of days to liquidate a given position or a proportion of a position will differ depending on the extent to which markets are stressed, together with any specific assumptions made about factors such as volume traded. If the expectation from the SEC is that Asset Managers should assume that markets are operating "normally" (at or near to average market liquidity), the imposition of hard liquidity requirements such as the three-day-liquid-assets minimum is unlikely to assist the fund in meeting investor redemptions during stressed periods. In such a scenario, the fund would most likely need to rely on other tools and mechanisms (e.g. dilution tools) to enable the fund to meet redemption requests and treat investors fairly.

If the SEC is proposing that Asset Managers assume that market liquidity is restricted to those levels observed during stressed markets, this would require Asset Managers to hold relatively more liquid positions as part of their three-day-liquid-assets minimum. Such levels are likely to adversely impact a fund's ability to fulfil its fiduciary obligations and also impede the generation of returns for investors. Furthermore, it is possible during a materially stressed condition (e.g., a simultaneous decline in market liquidity and large redemption demands) the three-day-minimum-assets threshold would be unlikely to enable the fund to meet its liquidity demands.

AMG has a concern that investors may be discouraged from making appropriate investment decisions as a result of the proposed disclosures. For example, even the sale of a small percentage of one of the large index tracking funds (e.g., tracking the S&P 500) without market impact should be possible in normal market conditions but the sale of the entire fund would be highly likely to impact market prices. However, AMG does not believe that retail investors should thus be discouraged from such investments.

QUESTION 19

What factors do funds currently use to assess and classify the liquidity of portfolio assets, and do the proposed factors reflect factors that funds already consider when evaluating portfolio assets' liquidity?

AMG considers numerous factors when assessing securities, instruments, and positions to classify the liquidity of portfolio assets. Some of the more reliable and quantifiable factors are directly incorporated into the liquidity risk model used by AMG. Others require a more qualitative assessment and are incorporated more subjectively into liquidity classifications. These general factors fall into three primary categories and include, but are not limited to:

i. **Market Characteristics**
- Number, diversity, and overall activity of market makers, broker-dealers, and other participants
- Exchange structure: exchange-traded, OTC, electronic platforms
- Central clearing requirements and capabilities

ii. **Security Characteristics**
- Issue/issuer credit quality and overall riskiness
- Industry, geography, currency denomination
- Security age and time to maturity
- Trading volumes
- Bid-ask spreads
- Degree of instrument standardization
- Other asset-specific factors: registration status, private debt/equity, halted-trading, etc.

iii. Position and Portfolio Characteristics

- Position sizes relative to historical traded volumes and outstanding issuance
- Odd lot position sizes
- Hedging nature of position

QUESTION 20

Do commenters agree that requiring a fund to consider certain factors would encourage effective liquidity assessment across the fund industry? Would considering certain factors improve funds' ability to meet their redemption obligations and to reduce potential dilution of non-redeeming shareholders? Would classification generally enhance funds' liquidity risk management, including funds' ability to meet their redemption obligations and to reduce potential dilution of non-redeeming shareholders?

In order to create a robust and holistic view of the risks within a portfolio, including liquidity risk, and the impact that these risks might have on the changing value of the fund over time, AMG supports the inclusion of all relevant inputs/factors. While the use of quantitative and qualitative factors may help inform industry practitioners of liquidity in unstressed market conditions, the challenge is deriving a set of meaningful metrics to paint a true picture of liquidity with a high degree of confidence in periods of market stress that can also adapt to quickly changing conditions.

Even during normal market conditions, AMG would like to stress, while the factors themselves may help Asset Managers form a general view of liquidity, the analysis and the resulting metrics are often generated using historical looking data which can be frequently inaccurate or incomplete, requiring the use of assumptions and approximations. These limitations have a compounding affect which eventually distort the relevance, use and applicability of the metrics thereby ultimately preventing Asset Managers from estimating market liquidity with a high degree of confidence.

The SEC's assertion that *"high average trading volume also tends to be correlated with greater liquidity*" appears intuitive in that it should be easier to transact when markets are more active. However, research using empirical U.S. government bond and stock market data to explain how volume and liquidity seem unrelated over time[4] suggests that volume positively predicts **variance** in liquidity and not liquidity itself.

Furthermore, assets that don't trade regularly aren't always illiquid. Trading volume and price are correlated but are not mutually exclusive factors. An asset that exhibits high trading volumes does not automatically enable the Portfolio Manager / Trader to convert its position to cash at a price that does not materially affect the value of that asset immediately prior to sale in stressed markets – the ability to do this depends on a number of factors such as investors' appetite for risk and the perceived "safety" of specific securities in "risk-off" flight-to-quality market conditions. Furthermore, high trading volumes might be associated with high selling pressure on the asset and trades at that time may have a material price impact.

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4. Johnson, T.C. (2007). Volume, Liquidity & Liquidity Risk. Journal of Financial Economics. Retrieved from: http://business.illinois.edu/tcj/papers/JFE_2008.pdf

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QUESTION 21

Should any of the proposed factors not be required to be considered by a fund in making liquidity determinations? Should any of the proposed factors be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider in evaluating the liquidity of a portfolio position in a particular asset?

For OTC securities, a number of additional checks could be considered such as whether there are any legal or practical (including contractual) limitations on terminations, transferability, or sale as well as the number of brokers who have signed agreements (e.g., ISDA) to transact with the fund in question and/or willing to assign contracts.

QUESTION 22

Do commenters agree that the proposed three-day liquid asset minimum requirement would improve a fund's ability to meet redemption requests without materially affecting the fund's NAV? Do commenters agree that the proposed requirement would promote investor protection by enhancing funds' ability to meet their redemption obligations, mitigating dilution, and elevating the overall quality (comprehensiveness as well as independence) of liquidity risk management across the industry?

AMG believes the three-day liquid asset minimum would prove ineffective in stressed market conditions, given the challenges associated with measuring market liquidity. AMG also questions how well a mechanistic metric such as the three-day liquid asset minimum will enable a fund to always meet redemption requests during normal market conditions.

QUESTION 23

As noted above, the 15% standard would be tested each time the fund acquires new assets, and a fund would be permitted to hold more than 15% of its net assets in 15% standard assets if it does so due to redemptions or market events. Once a fund rises above the 15% limit, any acquisition of new assets must be of non-15% standard assets until the fund is at or below the 15% standard. Would a requirement mandating that a fund divest excess 15% standard assets if its holdings of these assets rise above 15% of its net assets better facilitate funds' liquidity risk management and promote investor protection? Or should we limit the time period (e.g., to 30 days, 60 days, or 90 days) in which a fund holds more than 15% of its net assets in 15% standard assets so that a fund cannot persistently be above the 15% standard? Alternatively, we note that certain Canadian mutual funds are subject to illiquid asset restrictions that provide that a fund: (i) must not acquire illiquid assets if more than 10% of the fund's net assets would be made up of illiquid assets; (ii) must not have invested more than 15% of the fund's net assets in illiquid assets for a period of 90 days or more; and (iii) must, as quickly as is commercially reasonable, take all necessary steps to reduce the percentage of its net assets made up of illiquid assets to 15% or less if more than 15% of the fund's net assets is made up of illiquid assets. Should we adopt similar requirements? Would such requirements better promote investor protection?

AMG does not believe imposing a fixed time period in which holdings above the 15% threshold must be divested would be helpful as it may force sales at depressed prices to the detriment of continuing investors.

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QUESTION 24

What are funds' current practices for determining whether a portfolio asset is limited by the 15% guideline, and what factors do funds currently use to make this determination? Who at the fund and/or the adviser is tasked with determining whether a portfolio asset is limited by the 15% guideline, and how often is each asset reviewed? Do funds expect to engage in the same practices for determining whether an asset is a 15% standard asset?

While Portfolio Managers and Traders continually evaluate position liquidity as part of the investment decision-making and trade execution processes, the Asset Manager's Risk Management function is generally responsible for evaluating portfolio holdings and positions to identify potentially less liquid and illiquid securities for determining whether a portfolio asset is limited by the 15% guideline for illiquid assets.

An important tool in assessing position liquidity used by the AMG Risk function is the internally developed liquidity risk model. This model assesses the liquidity of an asset based on the culmination of numerous market and security characteristics including, but not limited to, market structure, trading volumes, bid-ask spreads, issue/issuer credit quality and overall riskiness, security age and time to maturity, degree of instrument standardization, and other asset-specific factors. All securities identified as "less liquid" by the model undergo further evaluation by the Risk Management function to confirm whether the security and/or position is deemed "illiquid", one which requires more than seven days to liquidate and would therefore be limited by the 15% guideline. Within the US, this liquidity assessment is performed by the Risk Management function at least every two weeks; the liquidity determination for each portfolio, including identification of illiquid securities, are certified by the Chief Risk Officer and presented to the Fund's Board quarterly.

<u>It is expected that the funds will engage in the same, if not similar, practices for determining whether an assets is a 15% standard asset.</u>

QUESTION 25

Would it be beneficial to funds for the Commission to include as part of the rule certain types of securities whose acquisition would be limited by the 15% standard, or other factors for funds to consider in determining whether an asset is a 15% standard asset? Do commenters believe that confusion could arise between the definition of a 15% standard asset and the definition of a less liquid asset under the proposed rule, and if so, how could this confusion be reduced?

Rule 2a-7 currently defines the term "illiquid security" to mean "a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund." Should we amend rule 2a-7 to clarify that "illiquid security" has the same definition as "15% standard asset?"

If Asset Managers are forced to avoid illiquid securities, it is conceivable that investors may lose access to certain asset classes and / or investment opportunities. Forcing Asset Managers to hold back more liquidity removes the investor's ability to choose what risks they wish to be exposed to and thereby limiting the potential returns they desire. There may be certain funds that invest in asset classes such as Emerging Markets Equity, where the broad majority of the fund is comprised of less liquid holdings and may not be able to meet the requirements of the three-day liquid assets at all times. Nevertheless, the asset class may be attractive to investors from a risk/return premia perspective.

AMG believes the imposition of hard liquidity limits would give the average investor the illusion that they will always have "liquidity at will" especially in asset classes where they should not have that expectation. AMG would like to reiterate that investors must understand that investing in the financial markets involves risk and the liquidity associated with investing in a fund is both practically and legally different to the liquidity obligations bestowed upon a bank depository.

AMG recommends the SEC considers whether the imposition of these new rules could have unintended effects on market liquidity. There is the potential that these proposals could intensify the threat of declining market liquidity by increasing aversion to less liquid assets, particularly for smaller issues and less traded sectors such as emerging markets and high yield securities, which are already traded less frequently; as a result the industry could see marginally weaker interest from bond mutual funds and ETFs.

QUESTION 26

Do fund boards currently approve procedures for classifying the liquidity of portfolio assets? Do fund boards take any additional steps to oversee the liquidity of portfolio assets? Should the Commission require boards, including a majority of independent directors, to approve the initial liquidity risk management program, including the three-day liquid asset minimum?

AMG agrees that the Fund Board should review and approve the processes employed, although the approval should be such that the Asset Manager is given the flexibility to react to rapidly changing market conditions without the need for Board pre-approvals.

While Fund Boards may approve the policies and high-level processes, they might experience difficulties in determining whether the overall approach sufficiently captures the nature of changing market liquidity for individual investments and for the fund as a whole without being given a detailed understanding of the underlying liquidity risk models e.g., how the underlying models have been programmed/parameterized, what assumptions have been made/proxies assigned where data is unavailable or considered unreliable.

QUESTION 27

Do commenters agree that swing pricing could be a useful tool for U.S. registered funds in mitigating potential dilution of fund shareholders?

AMG supports the ability to apply swing prices as AMG strongly believe funds should have as many options as possible to manage the potential conflicts between redeeming and continuing investors.

AMG has experience of implementing and managing anti-dilution approaches including partial swing pricing in a number of jurisdictions (Luxembourg, UK and Ireland) and efforts are underway to implement a partial swing approach within France following a recent change in regulation.

Trading costs and spreads associated with underlying transactions can vary depending on liquidity of the asset type and individual securities. Existing investors should not be paying for the trading activity of other investors hence the preference for an anti-dilution mechanism such as partial swing pricing.

QUESTION 28

Do commenters agree that the proposed rule should require a fund that adopts swing pricing policies and procedures to adjust the fund's NAV when the fund's level of net purchases or redemptions exceeds the fund's swing threshold? Or should the proposed rule instead only require a fund that adopts swing pricing policies and procedures to adjust the fund's NAV when the fund's level of net redemptions exceeds the swing threshold? Alternatively, should the proposed rule permit a fund to choose whether to adopt swing pricing policies and procedures that would: (i) require the fund to adjust its NAV when the fund's level of net purchases or redemptions exceeds the fund's swing threshold; or (ii) require the fund to adjust its NAV only when the fund's level of net redemptions exceeds the fund's swing threshold? Are there greater concerns about the potential for dilution associated with net redemptions than those associated with net purchases?

AMG believes that swing price factors should be applied to both net purchases and redemptions in excess of the agreed threshold. AMG does not see there is greater risk with redemptions than with subscriptions. Subject to local market regulations and market practice, partial swing pricing policies are a useful tool to prevent the dilution of investors' returns. The adoption of a swing price procedure should not disadvantage the fund versus its competitor universe and should be adopted across all funds within the relevant sector, where appropriate, ensuring the fair treatment of investors.

QUESTION 29

Should a fund be permitted to use full swing pricing, as opposed to the partial swing pricing contemplated by the proposed rule? Why or why not?

AMG recognizes that for many US investors, swing pricing will be a new concept. However, AMG believes that both full and partial swing pricing mechanisms provide a useful compromise between the need to protect the interests of a fund's long term investors and the desire of many investors to deal in single priced funds without incurring a separate transaction charge such as an anti-dilution levy.

Some of the benefits of swing pricing reported by Association of the Luxembourg Fund Industry ("ALFI")[5,6] include:

- Funds that apply swing pricing show superior performance over time compared to funds (with identical investment strategies and trading patterns) that do not employ anti-dilution measures;
- Swing pricing helps preserve investment returns as the value to long-term investors normally exceeds the value of the swing factor applied on entry to or exit from the fund;
- In addition swing pricing should act as a deterrent to the short-term speculative investor(s) as their investment will need to have increased by more than twice the value of the swing factor for any gain to be realized; and
- Investors that trade at a swung price are effectively paying the dealing costs associated with their investment.

AMG recognizes some of the benefits of full swing pricing (e.g., transparent and easy to understand, consistent treatment of shareholder transaction on all dealing dates, always benefits the fund) but believes that partial swing pricing provides additional benefits, namely:

- As the capital activity must exceed the swing threshold before the net asset value price is swung, there is a lower exposure to net asset value miscalculations as a result of operational errors compared to using full swing.
- As the price is not swung on each valuation date there is normally a lower impact on net asset value volatility, tracking error and fund performance.

However, some commentators argue that partial swing pricing is more difficult to explain to investors and determining and monitoring the appropriate swing threshold is not without complications.

AMG has adopted a global approach to recommending swing pricing to Fund Boards, where permitted, and believes that a Fund's Board should have the discretion to determine whether to adopt a full or partial swing pricing solution.

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5. The Association of the Luxembourg Fund Industry (ALFI) (February 2011). Swing pricing, survey, reports & guidelines. Retrieved from http://www.alfi.lu/sites/alfi.lu/files/ALFI_Swing_Pricing.pdf
6. The Association of the Luxembourg Fund Industry (ALFI) (December 2015). Swing Pricing Guidelines. Retrieved from http://www.alfi.lu/node/3104

QUESTION 30

Under the proposed rule, when net purchases or net redemptions of a fund that has adopted swing pricing policies and procedures exceed the fund's swing threshold, the price that all purchasing or redeeming shareholders would receive for fund shares would be adjusted pursuant to the fund's swing pricing policies and procedures. Should a fund instead be permitted to exempt certain shareholders (for example, purchasing shareholders on days when the fund's share price is adjusted downward, or small shareholders whose purchase or redemption activity would not likely create significant liquidity costs for the fund) from receiving an adjusted share price on a day when the fund's net purchases or redemptions exceed the swing threshold? Why or why not?

<u>All investors should be treated fairly and exempting certain shareholders from the effects of the swing is contrary to the principle of swing pricing and doesn't create a standardized net asset value for which all investors have dealt.</u> The impact on the existing investors should be the same. If there is a requirement to have a differentiated approach depending on certain shareholder activity, an anti-dilution levy for institutional investors could be applied as an example but this would not work in conjunction with swing pricing. Certain AMG funds utilize semi-swing pricing in order to create a more equitable net asset value that is reflective of trading costs and protects the interests of existing investors.

<u>As previously noted, AMG has adopted a global approach to recommending swing pricing to Fund Boards, where permitted, and believes that a Fund's Board should have the discretion to determine whether to adopt a full or partial swing pricing solution.</u>

QUESTION 31

Would the use of purchase fees, redemption fees and/or liquidity fees (either separately or in combination) be a more or less effective means of mitigating potential dilution than swing pricing? Why or why not? Would the use of purchase fees, redemption fees and/or liquidity fees (either separately or in combination) entail burdens and costs that are higher or lower than the burdens and costs associated with swing pricing? What types of operational challenges would arise with swing pricing as opposed to purchase fees, redemption fees, and liquidity fees? Are purchase fees, redemption fees, and liquidity fees feasible for those funds whose shares are primarily held through third-party intermediaries?

Initial fees and redemption fees may widen the spread between buying and selling shares on the funds and is akin to dual pricing. This approach is transparent and fully reflects the cost of transaction for investors based on the underlying spreads of the assets held by the fund. However, the presence of two prices (bid and offer) does cause complications for distributors, particularly in Europe, as certain mutual fund structures tend to be single priced and third party platforms tend to rely on the use of one price for dealing. Investors are also less familiar with two prices for funds and therefore the dual price approach is less favored by European manufacturers and therefore may have the same impact in the US. **<u>As such, AMG would not be in favor of this approach.</u>**

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QUESTION 32

Would the use of dual pricing be a more or less effective means of mitigating potential dilution than swing pricing? What types of operational challenges would arise with swing pricing vs. dual pricing?

AMG believes in-kind redemptions are a useful way of managing dilutions providing that the costs of trading to support the in-kind movement (e.g., tax implications or any portfolio re-allocation) are factored into the in-kind redemption calculation. In-kind redemptions are only operationally practical for larger or institutional investors who are moving material assets. An approach such as this would not be practical or effective for retail investors.

QUESTION 33

Would allowing funds to require certain investors to accept in-kind redemptions in certain circumstances be a more or less effective means of mitigation potential dilution than swing pricing in those circumstances?

AMG believes in-kind redemptions are a useful way of managing any dilutions providing that the costs of any trading to support the in-kind movement (such as tax implications or any portfolio re-allocation) are factored into the in-kind redemption calculation. In-kind redemptions are only operationally practical for larger or institutional investors who are moving material assets. An approach such as this would not be practical or effective for retail investors.

QUESTION 34

Specifically, we request comment on the extent to which the swing pricing requirements incorporated into the proposed rule would reduce volatility and respond to transparency-related concerns. Would any performance volatility that could result from swing pricing result in market distortions if some funds adopt swing pricing but other, similarly situated funds do not? Do commenters believe that the use of partial swing pricing, as opposed to full swing pricing, would mitigate concerns that the swing pricing would increase a fund's volatility? Do these proposed requirements also effectively respond to transparency-related concerns associated with swing pricing, and would the proposed disclosure requirements regarding swing pricing also respond to transparency concerns? Would any alternative or additional swing pricing requirements more effectively respond to potential concerns about volatility or transparency (or any other concerns) associated with swing pricing?

AMG believes the implementation of a partial swing price would generate a less frequent movement of the net asset value and therefore result in less volatility in the performance return. Conversely, a fund with a full spread, which will most likely publish one price to the market and third party distributors (bid or offer), would create a wider movement in the net asset value and therefore could be perceived as being more volatile. The benefit of the full dual priced option is that the approach is transparent whereas the partial swing pricing method relies on the application of swing factors to calculate the movement of the net asset value. The generation of the swing factors is reliant on the historical data of previous trading activity per fund and the inclusion of various trading/brokerage costs, taxes and charges associated with the funds trading activity.

Disclosure on composition and the application of swing factors can be difficult for investors to understand and can change from one period to the next. **<u>While disclosure around the approach</u>**

and methodology of swing pricing is very important for investors, AMG believes it would be inappropriate to disclose swing factors or thresholds in the fund's legal documentation because AMG wants to avoid the potential for gaming. Further, for the factors to be effective, AMG requires the ability to change the factors quickly without having to wait for the changes in literature which can be slow and costly.

QUESTION 35

As proposed, rule 22c-1(a)(3) would permit, but not require, a fund to adopt swing pricing policies and procedures. What process do commenters anticipate that a fund may use to weigh the potential advantages and disadvantages of swing pricing in relation to the fund's particular circumstances and risks? Should each fund's board be required to determine whether swing pricing is appropriate for each fund? Should all funds, or a particular subset of funds (e.g., funds whose three-day liquid asset minimums are below a certain level, or whose less liquid assets are above a certain level) be required to use swing pricing?

AMG agrees that each Fund Board should be able to determine the appropriateness of implementing an anti-dilution approach including, but not limited to, swing pricing. All funds that fall under the same prospectus should ideally implement the same approach in order to provide a level of consistency and simplicity for investors. There are, however, circumstances whereby some funds in the same range, depending on the asset class, may not require a swing factor given the nature of the underlying assets (e.g. cash products). AMG supports the suggestion that funds with illiquid assets, such as commercial property or high yield bonds should be required to use swing prices given that some of these trading costs are relatively high compared to an equity fund for example, and the fund should ensure existing investors are not penalized for the trading activity of others (i.e. swing pricing is more important in these situations).

QUESTION 36

Proposed rule 22c-1(a)(3) would permit the person(s) responsible for administering a fund's swing pricing policies and procedures to make the determination of whether the fund's level of net purchases or redemptions has exceeded the fund's swing threshold "on the basis of information obtained after reasonable inquiry." Do commenters agree that this would be appropriate? Why or why not? Is the phrase "information obtained after reasonable inquiry" clear? If not, how could this term be clarified within the context of the proposed rule?

AMG is of the opinion that the thresholds of daily net inflows/outflows at which the net asset value will swing should not be disclosed in the fund's legal documentation. If net flows exceed these thresholds, the price should be swung.

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QUESTION 37

As proposed, rule 22c-1(a)(3) would require a fund to exclude any purchases or redemptions that are made in kind and not in cash when determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold. Is this exclusion appropriate? Why or why not?

AMG believes the exclusion of in-kind transfers from the daily net subscriptions and redemptions is appropriate. In-kind transfers should be based on a pro-rated slice of the portfolio assets and are normally transferred from one custodian to another but retained by the beneficial owner without incurring market trading costs.

QUESTION 38

Do commenters agree that the proposed rule should apply to all registered open-end management investment companies except money market funds and open-end ETFs?

AMG agrees that money market funds and open-end ETFs should be exempt from proposed rule 22c-1(a)(3). AMG is supportive of such mechanisms that protect the interests of existing investors equitably as the decision to implement swing pricing rests with the Fund Board and AMG believes that the implementation of swing pricing should be part of a number of liquidity management mechanisms to protect the interests of the existing investors. As previously stated, **AMG believes that the SEC has already taken valuable steps to address liquidity risk in money market funds in its 2a-7 reforms**.

QUESTION 39

Do commenters agree that the risk of investor dilution is low for closed-end investment companies and UITs, and thus closed-end investment companies and UITs should not be included within the scope of proposed rule 22c-1(a)(3)?

AMG agrees that closed ended funds are excluded form proposed rule 22c-1 (a)(3). The costs of trading the underlying assets are included in the set-up fee as part of the initial offer made to investors.

QUESTION 40

Is the definition of "swing threshold," as set forth in proposed rule 22c-1(a)(3) appropriate and clear? If not, how could this definition be clarified or made more effective within the context of the proposed rule?

AMG believes the definition of a swing threshold is comprehensive and clear.

QUESTION 41

Should a fund be permitted to adopt two swing thresholds—one for net redemptions and one for net purchases?

AMG does not see the benefit of having two swing thresholds (one for redemptions and one for net purchases) when implementing a swing pricing (full or partial) policy. The net position is derived from subscriptions minus redemptions which is then passed through the fund to implement trades in the market and the price will swing to bid/offer depending on the direction of flows. Only one threshold is therefore needed to determine whether the net asset value should be swung to bid or offer.

QUESTION 42

Should any of the proposed factors not be required to be considered by a fund in determining and reviewing its swing threshold? Should any be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider? Should we set a minimum floor for a fund's swing threshold (e.g., one percent, or some other percentage, of the fund's net asset value) to prevent a fund from setting a very low swing threshold? If so, what should it be and why?

The factors used to determine the threshold levels in the proposed rule are in line with AMG's expectations. Ideally, thresholds should not exist and the net asset value would swing depending on the net inflows or outflows. However, thresholds are in place to help ensure the net asset value does not swing too frequently and create a perceived level of volatility for the investor but also to ensure the net asset value only swings when there are material flows, reducing the net asset value adjustment requirement.

QUESTION 43

Do commenters agree that a fund that adopts swing pricing policies and procedures should be required to review its swing threshold at least annually? Do commenters anticipate that a fund that adopts swing pricing procedures would voluntarily choose to review its swing threshold any more frequently than annually? Alternatively, should a fund be required to review its swing threshold any more or less frequently than annually?

<u>**AMG supports the view that the swing pricing policies and thresholds should be regularly reviewed on a timeframe determined by the Fund Board.**</u> Relevant AMG funds publish the partial swing policy and threshold limits in their prospectuses and reviews of these thresholds are made at least annually as part of the prospectus update. However, swing factors which are not disclosed should be reviewed more frequently by the Funds Board with the Investment Advisor to capture material changes in spreads and market liquidity. AMG would not expect the SEC to provide guidance on threshold levels, but would support input from the Commission on the types of factors that Asset Managers should consider when establishing or reviewing thresholds.

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QUESTION 44
Is the definition of "swing factor," as set forth in proposed rule 22c-1(a)(3) appropriate and clear? If not, how could this definition be clarified or made more effective within the context of the proposed rule?

AMG believes the SEC's definition of the swing factor is appropriate and clear.

QUESTION 45
We request comment on each of the considerations that a fund would be required to take into account in determining the swing factor, pursuant to proposed rule 22c-1(a)(3)(i)(D). Would these considerations reflect the estimated or actual costs associated with purchasing or selling portfolio assets in order to meet purchases or redemptions of fund shares? Should any aspect of proposed rule 22c-1(a)(3)(i)(D) not be required to be considered by a fund in calculating the swing factor? Should any of the considerations be modified, and is the definition of "transaction fees and charges," as set forth in the proposed rule, appropriate and clear? Instead of codifying certain considerations that a fund must take into account in determining the swing factor, should we instead provide guidance on factors a fund may wish to consider in calculating the swing factor? Instead of using a swing factor to adjust a fund's NAV, is there an alternate means by which a fund should be permitted to adjust its NAV to mitigate potential dilution stemming from purchase or redemption activity (e.g., pricing its assets on the basis of bid prices, as opposed to pricing using the mean of bid and asked prices)?

AMG believes the considerations in formulating the swing factors should be reflective of the trading cost from a previous period in order to ascertain an expectation as to the swing factor for a future period. Therefore, the swing factors should ideally reflect actual trading activity although estimated trading costs can be used to set swing factors. In addition, the source of the market based information including spreads is important to provide an accurate view. Some Fund Boards will opt to use prices that are taken from the Administrator/Valuation Agent who use data vendors in the market (i.e. Bloomberg etc.), whereas other Fund Boards will use actual trade dealing information collated by the Traders to provide a more accurate assessment of prices paid to brokers in order to determine the appropriate spreads and therefore swing factors. **AMG would support either approach as it is dependent on market practice and local convention. Guidance on what inclusions should be made in calculating a swing factor will assist in delivering a level playing field across Asset Managers and for all groups looking to implement a swing pricing policy.**

QUESTION 46
We request comment on the approaches commenters believe a fund may take to determine its swing factor. For example, do commenters anticipate that a fund would set a "base" swing factor, and adjust it as appropriate if certain elements required to be considered in the swing factor deviate from a range of pre-determined norms? Do commenters believe that it would be feasible and likely that a fund may wish to use a formula or algorithm approach for determining the swing factor? What other approaches to determining the swing factor do commenters anticipate that a fund would be likely to take?

The base price is effectively the mid-price between the bid and offer prices. Swing factors are calculated on historical trading activity.

QUESTION 47

Do commenters agree that the Commission should not require an upper limit on the swing factor that a fund would be permitted to use? Why or why not? If not, what upper limit would be appropriate (e.g., 2%, or some other limit), and why? Should we specify different limits for different types of funds or investment strategies?

AMG agrees there should not be a regulatory requirement to disclose an upper limit on the swing factors in the documentation. However, in the interests of disclosure to investors, funds should ideally include an upper limit within the prospectus should they choose to employ them. **In periods of severe market stress, spreads and swing factors may widen and a hardcoded regulatory limit could be detrimental to existing investors. The inclusion of an upper swing factor limit in the prospectus provides some guidance to investors – this limit can only change if investors are notified accordingly.**

QUESTION 48

Do commenters agree that a fund should be permitted to adopt an upper limit on the swing factor it would apply, as part of the fund's swing pricing policies and procedures? Why or why not? To the extent that a fund does adopt an upper limit on the swing factor it would apply, should the fund be required to disclose this upper limit to shareholders?

AMG agrees that funds should be permitted to apply an upper limit, based on historical analysis, and the limit should be set to help ensure the underlying spreads should not exceed the swing limit. Any limit on the swing factors should be disclosed in the prospectus to investors or within supplemental documents.

AMG agrees funds can apply an upper limit in the prospectus based on historical analysis. The maximum limit should be set to help ensure that the swing limit does not exceed underlying spreads. Any limit on the swing factors should be disclosed in the prospectus to investors and investors should be notified to any changes to the limit.

QUESTION 49

Should each fund that adopts swing pricing policies and procedures be required, not only permitted, to adopt an upper limit on the swing factor it would apply?

AMG believes that each fund should not adopt an individual upper swing limit. Publishing a single limit for the fund range as oppose to individual limits is perceived to be easier for investors to understand.

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QUESTION 50

Do commenters agree that a fund's board, including a majority of the fund's independent directors, should be required to approve the fund's swing pricing policies and procedures (including the fund's swing threshold, and any swing factor upper limit specified under the fund's swing pricing policies and procedures), and any material changes thereto? Would these approval requirements ensure that a fund establishes and implements swing pricing policies and procedures that are in the interests of all of the fund's shareholders? Do commenters agree that the proposed independent director approval requirement would ensure that a fund's use of swing pricing benefits the fund's shareholders?

AMG agrees that the relevant Fund Board should approve the swing pricing policies. The policy and the threshold limits are normally proposed by the appointed Asset Manager and contained in the prospectus which is approved by the Board. As such, some Asset Managers may have separate internal policy and procedure documents in relation to swing factors/thresholds that require periodic review by the Fund Board as part of their own governance process.

QUESTION 51

Do commenters agree that it would be appropriate to require a fund's board to designate the fund's adviser or officers responsible for the administration of swing pricing policies and procedures, including responsibility for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached? Do commenters agree that the determination of the swing factor should be reasonably segregated from the portfolio management of the fund? Would this pose any difficulty for particular types of entities, for example funds managed by small advisers? Is there a better way to prevent conflicts between the portfolio manager's incentives and the process of determining a swing factor that most effectively prevents dilution of existing shareholders' interests in the fund? What officers (or functional areas) of a fund do commenters anticipate a fund's board would select to administer the fund's swing pricing policies and procedures, and do commenters anticipate that these persons (or functional areas) would overlap with the administrators of a fund's liquidity risk management program?

AMG agrees that a formal delegation to a body outside the Fund Board structure is appropriate to monitor and determine the swing factors and threshold limits as long as it is permitted under a service level agreement and does not create a conflict of interest. AMG is of the opinion that Portfolio Managers and/or Traders should have no authority to set swing factors, but instead should provide input into the calculation and analysis when determining the swing factors as they are likely to have a better understanding of transaction costs. Swing factors and their implementation are often managed by operational departments which maintain oversight and daily interaction with the Administrators and Depositories. **AMG would welcome the opportunity to use specialist input from Administrators and Service Providers to recommend swing factors and threshold limits particularly since this would offer an opportunity for a further independent check from the Asset Manager.**

QUESTION 52
Do commenters agree that a fund's board should not be required to approve each swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached, although the board would be required to approve the policies and procedures for determining the swing threshold? Why or why not?

AMG agrees that the Fund Board should approve the policies as well as the methodology for calculating the swing factors and the thresholds to be applied. These would be outlined in part within the prospectus and in full within the fund's valuation procedures for applying swing factors. However, the application of individual swing factors should be conducted by the Asset Manager, along with the Fund Accountant.

QUESTION 53
Should funds be required to have specific policies and procedures to address possible NAV errors?

AMG believes funds should have specific policies and procedures to address possible net asset value errors. As such, it is for the Fund Board and their delegates to determine appropriate action in relation to swing pricing misapplication leading to a net asset value error. This component should be included in the Asset Manager's procedures on NAV errors.

QUESTION 54
Do commenters agree that the proposed recordkeeping requirements are appropriate?

AMG believes the recordkeeping requirements are sufficient. Record of any material changes to swing factors and the supporting rationale from one period to the next should be recorded as part of the Board or relevant oversight committee's minutes together with the rationale for any changes.

QUESTION 55
We seek comment on the application of swing pricing to master-feeder funds. Do commenters generally agree that feeder funds should not be permitted to use swing pricing? Why or why not?

Normally feeder funds are subscribing or redeeming to an underlying mutual fund and any flows will be aggregated with other investor flows at the same dealing point. Generally, investors in feeder funds are likely to be retail investors. There are no security based assets with bid/offer prices held by the feeder and therefore AMG believes it is inappropriate to apply any swing price method specifically on feeder products. However for fund of funds there is an argument that their large subscription and redemption allocations to underlying mutual funds can swing the price for all investors. **<u>AMG is therefore not supportive of having different thresholds for fund of fund investors, particularly if they are from the same group.</u>**